

**The Internal Revenue Service Needs to
Improve Controls Over Computer Codes
Used to Accelerate Tax Enforcement Actions**

September 2001

Reference Number: 2001-10-187

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
FOR TAX
ADMINISTRATION

September 28, 2001

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service Needs to
Improve Controls Over Computer Codes Used to Accelerate Tax
Enforcement Actions

This report presents the results of our review of the Internal Revenue Service's (IRS) use of accelerated issuance codes to expedite tax enforcement actions. The overall objective of this review was to evaluate whether the controls over accelerated issuance codes would ensure timely removal of these codes when taxpayers become compliant and prevent improper input of these codes to taxpayer accounts.

In summary, we found that the IRS needs to improve its internal controls over the use of accelerated issuance codes on taxpayer accounts. There were accelerated issuance codes on the accounts of an estimated 106,900 individual and business taxpayers that have been compliant for at least 3 years. In addition, systemic controls were not designed to prevent the input of invalid accelerated issuance codes. Moreover, a number of accelerated issuance codes were used incorrectly or were input in error.

Management's Response: IRS management agreed to the recommendations presented in this report. Corrective actions taken or planned include re-evaluating the usage of accelerated issuance codes and establishing oversight and criteria for the input and removal of any accelerated codes that the IRS plans to continue using. In addition, systemic computer programs will be initiated to review accounts with accelerated issuance codes and reverse the codes based on specific criteria. Furthermore, management plans to remove incorrect and invalid accelerated issuance codes that we identified. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: We have two comments regarding the systemic computer programs that the IRS plans to initiate to review accounts with accelerated issuance codes and reverse the codes based on specific criteria:

- For codes that the IRS may use for future programs, the IRS' response indicates that the codes will be reversed if the taxpayer has been compliant with the tax law for 3 years or more. However, the IRS Restructuring and Reform Act of 1998¹ Section 3707(b) requires the IRS to reverse the code for taxpayers designated as non-filers once they have been compliant with the tax law for 2 years.
- Regarding the systemic removal of the Under-Withholding Civil Penalty (Questionable W4) program code from compliant taxpayer accounts, we believe the IRS should consider an implementation date sooner than the proposed date of October 1, 2003. This implementation date would leave this code on the accounts of an estimated 79,000 taxpayers for an additional 2 years, even though these taxpayers appear to have been compliant with the tax laws for at least the last 3 years.

Copies of this report are also being sent to the appropriate IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have any questions or John R. Wright, Acting Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

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The Internal Revenue Service Needs to Improve Controls Over Computer Codes Used to Accelerate Tax Enforcement Actions

Background

The Internal Revenue Service's (IRS) procedures allow for the use of computer codes on taxpayer accounts to identify certain types of non-compliance with the tax laws. These codes are known as accelerated issuance codes. When they are used, an indicator appears on the taxpayer's account and IRS enforcement actions are accelerated if the taxpayer is late in filing or paying taxes in the future.

IRS accelerated enforcement actions include reducing the number of notices sent to individual taxpayers from 5 to 2 and reducing the time between the first notice of a tax balance due and the initiation of collection enforcement action from approximately 180 days to between 60 and 80 days. Additionally, taxpayer accounts with accelerated issuance codes can be sent directly to IRS enforcement employees even though they may not otherwise be considered a priority.

The IRS Restructuring and Reform Act of 1998 (RRA 98)¹ Section 3707 prohibits the IRS from using one particular accelerated issuance code which identifies a taxpayer as an "Illegal Tax Protestor" (ITP). The United States Senate Finance Committee Report for this section of law stated that taxpayers may be stigmatized by being designated as an ITP. Consequently, the IRS was specifically instructed to remove the ITP code from its Masterfile² and to not designate taxpayers as ITPs or any similar designation. The IRS has successfully removed the ITP accelerated issuance code from its Masterfile.

However, IRS procedures continue to allow for the use of computer codes on accounts to identify taxpayers based upon certain types of non-compliance with the tax laws. Seven other accelerated issuance codes are used on the IRS Masterfile to expedite some type of enforcement action.

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² The Masterfile is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

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To classify a taxpayer's account for accelerated enforcement action, the IRS uses a Transaction Code (TC) 148 along with one of seven closing codes to identify various types of non-compliance. The following table shows all accelerated issuance codes and designations.

Accelerated Issuance Codes by Type

Taxpayer Account Indicator	TC 148 Closing Code	Description
Q	01	Delinquent Tax Return or Account Investigation
—	02	<i>Not an active code</i>
—	03	<i>Not an active code</i>
E	04	Under-Withholding Civil Penalty
T	05	Narcotics Income Case
U	06	Special Enforcement Program
N	07	False Refund Claim
S	08	Erroneous Refund
L	09	Letter 903 – Employment Tax ³

Source: Internal Revenue Manual.

These seven types of designations for which an accelerated code is used to expedite enforcement actions were not addressed by the RRA 98.

The audit was performed between August 2000 and July 2001. Fieldwork and interviews were performed with IRS officials in the National Headquarters, the Detroit Computing Center, and the former North Florida District. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

³ The District Office Notice of Intent to Revise Deposit Requirements for Employment Taxes (Letter 903) provides notice that the taxpayer may be subject to monthly filing requirements for employment returns.

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Controls Over the Use and Removal of Accelerated Issuance Codes Were Not Adequate

Accelerated issuance codes are used on taxpayer accounts to identify certain types of non-compliance with the tax law. However, for six of the seven codes reviewed, the IRS did not have adequate guidelines or procedures to determine when an accelerated issuance code and closing code should be input to the taxpayer's account. Further, the IRS did not have any guidelines or procedures that specify when to remove the accelerated code from the taxpayer's account. These guidelines are needed because after taxpayers become compliant and remain in compliance with the tax law, accelerated issuance codes no longer serve their intended purpose.

We obtained an IRS Masterfile extract of all individual and business taxpayer accounts containing an accelerated issuance code TC 148 with closing codes "01" through "09" as of August 20, 2000. There were 201,512 accounts with active codes in this extract. We reviewed a statistically valid sample⁴ for each of the TC 148 closing codes "01" through "09" to evaluate whether the taxpayers' history of non-compliance with the tax law indicated the code was still necessary.

Based upon the sample of taxpayer accounts reviewed for each of the 7 closing codes, approximately 106,900 (53 percent) of 201,500 accounts involved taxpayers that had been compliant with the tax law for at least 3 years. The following table provides our estimate of the number of taxpayers that had been compliant for at least 3 years for each accelerated issuance code reviewed.

⁴ See Appendix IV for sampling methodology.

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**Number of Taxpayer Accounts by
Type of Accelerated Issuance Code**

TC 148 Closing Code	Description	Taxpayer Accounts With a TC 148 Code	Taxpayers Compliant at Least 3 Years	Percentage of Compliant Taxpayers ⁵
01	Delinquent Tax Return or Account Investigation	19,924	12,307	62%
04	Under-Withholding Civil Penalty	131,181	79,369	60%
05	Narcotics Income Case	20	13	65%
06	Special Enforcement Program	1,399	825	59%
07	False Refund Claim	777	468	60%
08	Erroneous Refund	609	364	60%
09	Letter 903 – Employment Tax	47,602	13,569	28%
Totals:		201,512	106,915	53%

Source: IRS Masterfile extract of accelerated issuance codes as of August 20, 2000, and our review of a sample of associated accounts.

In addition to the lack of guidance on the use and removal of these codes, the other reasons that these codes remained on the accounts of taxpayers that have been compliant for at least 3 years include:

- The IRS recently restructured its organization into business units based upon the type of taxpayer served and had not yet established responsibility for these codes in its new organizational structure.
- Some of the accelerated issuance codes are no longer used by the IRS; however, these existing codes were not removed from taxpayer accounts.
- The IRS does not have a systemic computer program designed to remove these codes after a taxpayer becomes compliant with the tax laws.

The IRS generally sends taxpayers 5 notices during a 180-day period before enforcement action is initiated on

⁵ The percentage of compliant taxpayers for each closing code was calculated by dividing the “Taxpayers Compliant at Least 3 Years” column by the “Taxpayer Accounts With a TC 148 Code” column.

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accounts with overdue balances. For accounts with accelerated issuance codes, only two notices are sent to taxpayers. The final notice is issued 3 to 5 weeks after the first notice, followed by the initiation of enforcement action 6 weeks later. Therefore, the time period between the first notice to the initiation of the enforcement action can be reduced to approximately 60 to 80 days. Providing fewer notices and reducing the period of time to pay overdue taxes before enforcement action is taken may cause additional taxpayer burden for those taxpayers that have been compliant for at least the previous 3 years.

Additionally, the lack of adequate procedures over the use of accelerated issuance codes and the lack of criteria and systemic controls for the removal of these codes allow the codes and the associated indicators to remain on taxpayer accounts long after the taxpayers have become compliant. This may result in inconsistent and unfair treatment of taxpayers.

Recommendations

The Commissioners of the Small Business/Self-Employed Division and the Wage and Investment Division should:

1. Re-evaluate the accelerated issuance codes used to expedite enforcement actions and determine which accelerated issuance codes should be discontinued.

Management's Response: The IRS plans to discontinue the use of accelerated issuance codes with closing codes of "01," "05," "06," "07," and "08," but will retain codes "04" and "09" through "99."

The Office of Filing and Payment Compliance will have responsibility for code "09" and will use the code to indicate that a Letter 903 has been issued to the taxpayer. The Office of Reporting Compliance will be responsible for the use of codes "10" through "99" for the Automated Underreporter Program. Finally, the Wage and Investment Division will retain and have responsibility for code "04." The IRS does not input the code currently but will keep it available for future use and will review it again no later than September 30, 2002.

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2. Establish oversight responsibilities for those accelerated issuance codes selected for use in the new organization by:
 - Implementing criteria for the input and removal of each accelerated issuance code.
 - Ensuring that a systemic reversal is established for accelerated issuance codes in the future. These codes should be reversed once the taxpayers have met their tax obligations for the period of time specified by the newly implemented criteria.

Management's Response: The Office of Filing and Payment Compliance has initiated a Request for Information Services to reverse accelerated issuance codes where the taxpayer has been in compliance for 3 years or longer. This automated reversal will be effective October 1, 2002. In addition, the IRS has issued code removal guidelines to instruct revenue officers to reverse all TC 148 with closing code "09" if the taxpayer becomes compliant during the investigation.

The Office of Reporting Compliance will issue guidelines to give employees procedures for the input and removal of codes "10" through "99" and has requested system programming to reverse all accelerated issuance codes where the taxpayer has been in compliance for 3 years or longer.

The Wage and Investment Collection Strategy Unit is redesigning the Under-Withholding Civil Penalty (Questionable W4) system and will, if necessary, initiate systemic programming for the input and removal of code "04" after completion of the redesign.

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Office of Audit Comment: Regarding the systemic removal of the Questionable W4 program code from compliant taxpayer accounts, we believe the IRS should consider an implementation date sooner than the proposed date of October 1, 2003. This implementation date would leave this code on the accounts of an estimated 79,000 taxpayers for an additional 2 years, even though these taxpayers appear to have been compliant with the tax laws for at least the last 3 years.

3. Based on the criteria developed for the removal of each accelerated issuance code, remove existing codes from taxpayers' accounts as appropriate.

Management's Response: The Office of Filing and Payment Compliance has initiated systemic programming to conduct an automated annual review of codes "01," "05," "06," "07," "08," and "09" and will reverse any of these codes if the taxpayer has been in compliance for 3 years or more. The Office of Reporting Compliance will request systemic programming to create an annual review of codes "10" through "99" and reverse any of these codes if the taxpayer has been in compliance for 3 years or more. The Wage and Investment Collection Strategy Unit, if necessary, will initiate systemic programming for the Questionable W4 program that will include any criteria for removal of code "04."

Office of Audit Comment: For codes that the IRS may use for future programs, the IRS' response indicates that the codes will be reversed if the taxpayer has been compliant with the tax law for 3 years or more. However, RRA 98 Section 3707(b) requires the IRS to reverse the code for taxpayers designated as non-filers once they have been compliant with the tax law for 2 years.

The Correct Codes Were Not Always Used When Accelerating Tax Enforcement Actions

The accelerated issuance closing code identifies the type of non-compliance so that the appropriate enforcement action can be expedited. To determine whether the IRS controls over accelerated issuance codes prevent incorrect codes from being input to taxpayer accounts, we evaluated whether these codes were correctly input based upon the definition of the codes in the Internal Revenue Manual. We reviewed individual and business taxpayer accounts with an

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accelerated issuance code, TC 148, input to the Masterfile between August 1999 and August 2000.

For this 12-month period, there were 1,474 accelerated issuance codes input to taxpayers' accounts on the IRS' Masterfile.⁶ We reviewed IRS computer file information and case histories to determine if the accelerated issuance codes were valid and input correctly.

We estimate that 488 (33 percent) of the 1,474 taxpayer accounts were miscoded based upon the definition of the codes. We identified the following inaccuracies:

- In 446 cases,⁷ the closing code "09" was used incorrectly. This code indicates that a Letter 903 was sent to the taxpayer. However, the case histories did not contain any documentation that a Letter 903 was actually considered or mailed. Further, 32 of these accounts were for individuals who had no employment tax filing or payment requirements.
- In 37 cases, the closing code "01" was input in error. For 24 of these cases, the closing code should have been "09." Without this code, IRS employees will not know that a Letter 903 was sent. For the other 13 cases, we could not determine why the code was used because there was no indication of non-compliance on the accounts at the time the code was input.
- In 5 cases, the accelerated issuance codes were outside the valid range of closing codes ("01" through "09").

We also reviewed the entire Masterfile extract for accelerated issuance codes that were outside the valid range of closing codes. There were 32 additional invalid closing codes that were input before August 20, 1999.

⁶ Of the 201,512 active accelerated issuance codes on the IRS Masterfile as of August 2000, there were 200,038 input before August 1999 and 1,474 input between August 1999 and August 2000.

⁷ This number is based on our review of all individual accounts and a statistically valid sample of business accounts. See Appendix IV for additional information.

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The estimated 446 accounts that incorrectly contained the closing code “09” were caused primarily by the use of local procedures in certain IRS field offices to identify taxpayers that were still in business but had a previous history of non-compliance. IRS officials were unable to provide documentation that this variance from national procedures was authorized. For these accounts, an IRS enforcement employee could assume that a Letter 903 was properly sent to warn the taxpayer that non-compliance could result in a more frequent filing and payment requirement when, in fact, the taxpayer had not been notified.

Other coding errors were caused because accelerated issuance codes were not correctly keyed when input into the computer (37 of these were invalid codes). IRS management stated that systemic controls were not designed to prevent the input of some of the codes that are currently not valid because the IRS may use these codes for its compliance programs in the future. Incorrect and invalid codes reduce the reliability of information on IRS systems and the effectiveness of the accelerated issuance process for the cases requiring accelerated enforcement actions.

Recommendations

The Commissioners of the Small Business/Self-Employed Division and the Wage and Investment Division should:

4. Refine the computer validity check to prevent the input of accelerated issuance codes that the IRS does not use.

Management’s Response: The Office of Filing and Payment Compliance will eliminate all accelerated issuance codes the IRS no longer uses. Once eliminated, employees will no longer be able to input these codes.

5. Remove the incorrect and invalid accelerated issuance codes that we identified on taxpayer accounts.

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Management's Response: The Office of Filing and Payment Compliance has initiated systemic programming to remove incorrect and invalid accelerated issuance codes by reversing all codes where the taxpayer is in compliance with filing and payment requirements for 3 years or more.

The Office of Reporting Compliance will request systemic programming to remove the incorrect and/or invalid codes from taxpayer accounts.

Detailed Objective, Scope, and Methodology

The objective of this audit was to evaluate whether the Internal Revenue Service's (IRS) controls over accelerated issuance codes would ensure timely removal of these codes when taxpayers become compliant and prevent improper input of these codes to taxpayer accounts. We conducted the following tests to accomplish this objective.

- I. To determine whether the IRS is properly removing accelerated issuance codes from taxpayer accounts when taxpayers reach or maintain compliance with the tax laws, we performed the following tests:
 - A. Researched national and local guidelines, policies, and procedures for accelerated issuance codes. This included identifying all tax enforcement programs that used an accelerated issuance code and the criteria used to input and remove accelerated issuance codes for each program.
 - B. Interviewed national and local IRS employees and identified controls, criteria, responsibility, and procedures used to input and remove each type of accelerated issuance code.
 - C. Obtained and reviewed an individual and business Masterfile¹ computer extract as of August 20, 2000, for all accounts with accelerated issuance codes (Transaction Code (TC) 148). We reviewed the database for accuracy and validity. There were 201,512 accounts with active accelerated issuance codes on this database.
 - D. Selected statistically valid random samples using attribute sampling technique in order to estimate the total number of accounts in which the taxpayer had been compliant with the tax law for at least 3 years.² The taxpayer accounts were stratified by type (individual and business) and by each of the seven active closing codes for TC 148. There were two closing codes ("02" and "03") that were inactive. We sampled each of the strata based upon a 95 percent confidence level and 4 percent precision level and the error rate determined from a preliminary sample. For codes that were on only a limited number of taxpayer accounts (less than 150 accounts), we reviewed 100 percent of the accounts.

¹ The Masterfile is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

² See table in Appendix IV for sample sizes.

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- E. Based upon the samples selected in step I.D., we reviewed taxpayer account transcripts and computer on-line file information to identify accelerated issuance codes that were on the accounts of taxpayers that were currently compliant and had been compliant with all tax obligations for at least 3 years. Using the results of this review, we estimated the total number of taxpayer accounts meeting these criteria.
- II. To determine whether the IRS' internal controls are in place to detect or prevent coding errors or outdated accelerated issuance indicators, we performed the following tests:
- A. Reviewed an individual and business Masterfile computer extract of all taxpayer accounts with accelerated issuance codes as of August 20, 2000, and identified those taxpayers with accelerated issuance codes input between August 1999 and August 2000. There were a total of 1,474 taxpayer accounts meeting these criteria.
- B. Reviewed taxpayer accounts with the two major closing codes, "01" and "09," and invalid closing codes that had been input to taxpayers' accounts from August 1999 to August 2000. Our review included:
- All taxpayer accounts with TC 148, closing code "01."
 - All individual taxpayer accounts with a TC 148 closing code "09."
 - A statistically valid sample of 105 business taxpayer accounts with a TC 148 closing code "09."³
 - All taxpayer accounts with invalid closing codes ("10" through "99").
- C. Based on the accounts selected in step II.B., we reviewed Masterfile account transcripts and computer on-line file information and accessed the Integrated Collection System (ICS)⁴ for applicable case histories. We identified taxpayer accounts with incorrect or invalid codes. We also reviewed the entire Masterfile extract (obtained in step I.C.) for accelerated issuance codes that were outside the valid range of closing codes.

³ The sample size is based on a 95 percent confidence level, a precision rate of 9 percent, and a 43 percent error rate.

⁴ The ICS is a computer system that is specifically dedicated to IRS collection processing.

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner N:C
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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 106,915 accounts with accelerated issuance codes involve taxpayers that have been compliant with the tax law for at least 3 years (see page 3).

Methodology Used to Measure the Reported Benefit:

We obtained an Internal Revenue Service (IRS) Masterfile¹ extract of all individual and business taxpayer accounts that contained an accelerated issuance transaction code (TC) 148 as of August 20, 2000.² The number of taxpayer accounts containing an accelerated issuance code TC 148 with closing codes “01” through “09” totaled 201,512.

We selected a statistically valid random sample in which taxpayer accounts were stratified by type of taxpayer (individual and business) and by each of the seven closing codes for TC 148. We sampled each of the strata based upon a 95 percent confidence level, 4 percent precision level, and the error rate determined from a preliminary sample. For codes that were on only a limited number of taxpayer accounts (between 1 and 150 accounts), we reviewed 100 percent of the associated accounts. For the overall number and percentage of taxpayer accounts that were compliant with the tax law for at least 3 years, the confidence level is 95 percent and the precision level is 2.7 percent based upon the actual error rate.

For the taxpayer accounts selected in our samples, we reviewed Masterfile transcripts and researched IRS computer on-line information to determine taxpayer compliance. We evaluated whether taxpayers were compliant for the samples selected by first identifying any taxpayer account modules³ that had returns filed for the tax periods 1997, 1998, and 1999. Taxpayer accounts indicating a non-filing condition, late filing, or a balance due at time of filing were considered to be non-compliant. In addition, we reviewed any remaining active taxpayer account modules including those with returns that may not have been filed for the tax periods covering 1997 – 1999. Those accounts not having any balance due amount or a non-filing

¹ The IRS’ database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

² The input dates for these codes on the active IRS Masterfile ranged from October 1966 to August 2000.

³ A tax module is a part of a taxpayer’s account which includes information for one type of tax for one tax period. Taxpayers have only one account on the Masterfile but can have numerous tax modules.

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condition were also considered to be compliant. If returns were not filed for an account, it was considered to be compliant if there was no indication on the account that a return was required to be filed. The following table shows the number of cases reviewed in each sample as well as our estimate of the number of taxpayers that had been compliant for at least 3 years for each 7 accelerated issuance codes reviewed:

Number of Taxpayer Accounts and Number of Sample Cases Reviewed by Type of Accelerated Issuance Code

Taxpayer Account Indicator	TC 148 Closing Code	Description	Taxpayer Accounts With TC 148 Codes Sampled	Sample Taxpayer Accounts Compliant at Least 3 Years	Percentage of Taxpayers Compliant at Least 3 Years	Population of Taxpayer Accounts With TC 148 Codes	Estimated Total Number of Taxpayers Compliant at Least 3 Years
Q	01	Delinquent Tax Return or Account Investigation	1133	703	62%	19,924	12,307
E	04	Under-Withholding Civil Penalty	604	364	60%	131,181	79,369
T	05	Narcotics Income Case	20	13	65%	20	13
U	06	Special Enforcement Program	429	255	59%	1,399	825
N	07	False Refund Claim	338	203	60%	777	468
S	08	Erroneous Refund	390	230	60%	609	364
L	09	Letter 903 – Employment Tax	828	230	28%	47,602	13,569
Totals:			3,742	1,998	53%	201,512	106,915

Source: IRS Masterfile extract of accelerated issuance codes as of August 20, 2000, and our review of a sample of associated accounts.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 520 taxpayer accounts were miscoded with incorrect and invalid codes. This included 488 accounts with accelerated issuance codes input between August 20, 1999, and August 20, 2000, and 32 taxpayer accounts with invalid accelerated issuance codes input before August 20, 1999 (see page 6).

Methodology Used to Measure the Reported Benefit:

We reviewed the IRS Masterfile extract of all individual and business taxpayer accounts that contained an accelerated issuance transaction code TC 148 as of August 20, 2000.

The number of taxpayer accounts containing an accelerated issuance code TC 148 with closing codes “01” through “09” totaled 201,512. We selected those accounts with codes input from August 20, 1999, to August 20, 2000. For the 12-month period, we identified 1,474 active accelerated issuance codes that were input to the IRS Masterfile.

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We reviewed taxpayer accounts with the two major closing codes, “01” and “09,” and invalid closing codes that had been input to taxpayers’ accounts from August 1999 to August 2000. Our review included:

- All taxpayer accounts with TC 148, closing code “01.”
- All individual taxpayer accounts with a TC 148 closing code “09.”
- A statistically valid sample of business taxpayer accounts with a TC 148 closing code “09.”
- All taxpayer accounts with invalid closing codes (“10” through “99”).

For these taxpayer accounts, we reviewed Masterfile transcripts, researched IRS computer on-line information, and accessed the IRS’ Integrated Collection System (ICS)⁴ database for collection case histories to determine the correctness and validity of these accelerated issuance codes. The following table summarizes the results of our review.

**Taxpayer Accounts With Accelerated Issuance Codes Input
from August 20, 1999, to August 20, 2000, and Number of Sample
Cases Reviewed by Type of Accelerated Issuance Code**

TC 148 Closing Code	Description	Taxpayer Accounts With TC 148 Codes	Taxpayer Accounts Reviewed	Incorrectly Coded Taxpayer Accounts
00		2	0	—
01	Delinquent Tax Return or Account Investigation	206	206	37
04	Under-Withholding Civil Penalty	0	0	—
05	Narcotics Income Case	0	0	—
06	Special Enforcement Program	1	0	—
07	False Refund Claim	0	0	—
08	Erroneous Refund	0	0	—
09	Letter 903 – Employment Tax	1,260	137	446 ⁵
10 – 99		5	5	5
All		1,474	380	488

Source: IRS Masterfile extract of accelerated issuance codes input from August 20, 1999, to August 20, 2000, and our review of associated accounts.

⁴ The ICS is a computer system that is specifically dedicated to IRS collection processing.

⁵ For closing code “09,” we reviewed all 32 individual taxpayer accounts and a sample of 105 out of 1,228 business taxpayer accounts. All 32 individual accounts were incorrectly coded and 45 business accounts in the sample were incorrectly coded. The overall error rate for the business taxpayer accounts was estimated to be between 414 and 636 accounts based on the 43 percent error rate in the sample (45 of 105), a 95 percent confidence level, and a precision rate of 9 percent. The estimated 414 business accounts were combined with the 32 individual accounts for a total of 446 accounts that we estimated to be incorrectly coded.

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In addition to the 488 taxpayer accounts with incorrect codes that were input between August 20, 1999, and August 20, 2000, we also reviewed the entire Masterfile extract for accelerated issuance codes that were outside the valid range of closing codes. There were 32 additional invalid closing codes input before August 20, 1999.⁶

⁶ The input dates for these codes on the active IRS Masterfile ranged from February 1985 to August 2000.

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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

SEP 21 2001

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Joseph G. Kehoe *Richard J. Morgante*
Commissioner, Small Business/Self Employed

SUBJECT: Draft Audit Report – The Internal Revenue Service Needs to Improve Controls Over Computer Codes Used to Accelerate Tax Enforcement Actions (Audit 200010039)

Thank you for the opportunity to respond to the draft report. I agree we need to re-evaluate both the use and the control of the accelerated issuance codes. We have already completed our evaluation and are taking action to discontinue use of those codes we no longer need. In addition, action is underway to improve our internal control over their use.

The results of our evaluation and the actions planned are detailed in our comments to your recommendations.

IDENTITY OF RECOMMENDATION 1

Re-evaluate the accelerated issuance codes used to expedite enforcement actions and determine which accelerated issuance codes should be discontinued.

ASSESSMENT OF CAUSE

We no longer use a number of the accelerated issuance codes and should discontinue them.

CORRECTIVE ACTION

Small Business/Self - Employed, Wage and Investment and Criminal Investigation have reviewed the accelerated issuance codes and chose to discontinue the use of accelerated issuance codes (closing codes) 01, 05, 06, 07, and 08. Criminal Investigation agrees with these actions.

Small Business/Self – Employed will retain closing codes 09 through 99. The Office of Filing and Payment Compliance will have responsibility for closing code 09 and the Office of Reporting Compliance will have responsibility for closing codes 10 through 99. Accelerated issuance code 09 is used to indicate we have issued a Letter 903 to a taxpayer. We use codes 10 through 99 for the Automated Underreporter Program.

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Wage and Investment will retain and have responsibility for closing code 04. We do not use the code currently but keep it available for future use. Wage and Investment will review this code again no later than September 30, 2002.

IMPLEMENTATION DATE

Completed September 4, 2001

RESPONSIBLE OFFICIALS

Director, Filing and Payment Compliance, Small Business/Self-Employed
Director, Reporting Compliance, Small Business/Self-Employed
Director, Collection Strategy, Wage and Investment

CORRECTIVE ACTION MONITORING PLAN

N/A

IDENTITY OF RECOMMENDATION 2

Establish oversight responsibilities for those accelerated issuance codes selected for use in the new organization by:

- Implementing criteria for the input and removal of each accelerated issuance code.
- Ensuring that a systemic reversal is established for accelerated issuance codes in the future. These codes should be reversed once the taxpayers have met their tax obligations for the period of time specified by the newly implemented criteria.

ASSESSMENT OF CAUSE

Due to the changes made to the accelerated issuance codes, we must establish new oversight criteria.

CORRECTIVE ACTION 2.1

The Office of Filing and Payment Compliance, Small Business/Self-Employed, has completed a Request for Information Services (RIS) to reverse all accelerated issuance codes where the taxpayer has been in compliance for three years or longer (codes 01, 05, 06, 07, 08, and 09). This automated reversal will be effective October 1, 2002. In addition, we issued guidelines April 18, 2001, instructing revenue officers to reverse all TC 148 cc 09 if the taxpayer becomes compliant during the investigation.

IMPLEMENTATION DATE

October 1, 2002

RESPONSIBLE OFFICIAL

Director, Filing and Payment Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN

The appropriate Filing and Payment Compliance staff will keep their Director advised of any delays.

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CORRECTIVE ACTION 2.2

The Office of Reporting Compliance, Small Business/Self-Employed, will issue guidelines to give employees procedures for the input and removal of codes 10-99. In addition, a RIS has been requested to reverse all accelerated issuance codes where the taxpayer has been in compliance for three years or longer.

IMPLEMENTATION DATE

October 1, 2003

RESPONSIBLE OFFICIAL

Director, Reporting Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN

The appropriate Reporting Compliance staff will keep their Director advised of any delays.

CORRECTIVE ACTION 2.3

Wage and Investment (W&I), Collection Strategy will be responsible for implementing the criteria for the inputting and removal of issuance code 04. W&I will request a RIS for code 04 after a task force has completed its redesign of the Questionable W4 system.

IMPLEMENTATION DATE

October 1, 2003

RESPONSIBLE OFFICIAL

Director, Collection Strategy, Wage and Investment

CORRECTIVE ACTION MONITORING PLAN

The appropriate W&I staff will keep the Director, Collection Strategy advised of any delays.

IDENTITY OF RECOMMENDATION 3

Based on the criteria developed for the removal of each accelerated issuance code, remove existing codes from taxpayers' accounts as appropriate.

ASSESSMENT OF CAUSE

Existing codes on taxpayer's accounts may not be appropriate.

CORRECTIVE ACTION 3.1

Information Services approved a RIS submitted by the Office of Filing and Payment Compliance on June 15, 2001. It provides an automated annual review of codes 01,05,06,07,08, and 09 and will reverse any of these codes if the taxpayer has been in compliance for three years or more.

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IMPLEMENTATION DATE:
October 1, 2002

RESPONSIBLE OFFICIAL
Director, Filing and Payment Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN
The appropriate Filing and Payment Compliance staff will keep their Director advised of any delays.

CORRECTIVE ACTION 3.2
The Office of Reporting Compliance will request a RIS to create an annual review of codes 10 through 99 and to reverse any of these codes if the taxpayer has been in compliance for three years or more.

IMPLEMENTATION DATE
October 1, 2003

RESPONSIBLE OFFICIAL
Director, Reporting Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN
The appropriate Reporting Compliance staff will keep their Director advised of any delays.

CORRECTIVE ACTION 3.3
The Wage and Investment RIS for the Questionable W4 program will include any criteria for systemic removal of the code.

IMPLEMENTATION DATE
October 1, 2003

RESPONSIBLE OFFICIAL
Director, Collection Strategy, Wage and Investment

CORRECTIVE ACTION MONITORING PLAN
The appropriate W&I staff will keep the Director, Collection Strategy advised of any delays.

IDENTITY OF RECOMMENDATION 4
Refine the computer validity check to prevent the input of accelerated issuance codes that the IRS does not use.

ASSESSMENT OF CAUSE
Because certain accelerated issuance codes were eliminated, their input should be prohibited.

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CORRECTIVE ACTION

The RIS requested by Filing and Payment Compliance will eliminate all accelerated issuance codes the IRS no longer uses. Once eliminated, employees will no longer be able to input these codes.

IMPLEMENTATION DATE:

March 31, 2003

RESPONSIBLE OFFICIAL

Director, Filing and Payment Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN

The appropriate Filing and Payment Compliance staff will keep their Director advised of any delays.

IDENTITY OF RECOMMENDATION 5

Remove the incorrect and invalid accelerated issuance codes that we identified on taxpayer accounts.

ASSESSMENT OF CAUSE

During the audit, Treasury Inspector General for Tax Administration (TIGTA) identified taxpayer accounts with accelerated issuance codes that they believed were incorrect or invalid.

CORRECTIVE ACTION 5.1

We will remove incorrect and invalid accelerated issuance codes by reversing all codes where the taxpayer is in compliance with filing and payment requirements for three years or more. The Office of Filing and Payment Compliance has completed a RIS to accomplish this action.

IMPLEMENTATION DATE

October 1, 2002

RESPONSIBLE OFFICIAL

Director, Filing and Payment Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN

The appropriate Filing and Payment Compliance staff will keep their Director advised of any delays.

CORRECTIVE ACTION 5.2

The Office of Reporting Compliance will request a RIS to remove the correct and/or invalid codes from taxpayer accounts.

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IMPLEMENTATION DATE

October 1, 2003

RESPONSIBLE OFFICIAL

Director, Reporting Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN

The appropriate Reporting Compliance staff will keep their Director advised of any delays.

If you have any questions, please call Martha Sullivan, Deputy Director Compliance Policy, Small-Business/Self –Employed, at 202-283-2144, or Martin Berdan, Director, Collection Strategy, at 404-338-8674.